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Supreme Court of the United States

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No. 357.

ALBERT OTTINGER, as Attorney General of The State of New York,

Appellant,

vs.

CONSOLIDATED GAS COMPANY OF NEW YORK.

REPLY BRIEF ON BEHALF OF APPELLANT ALBERT OTTINGER AS ATTORNEY-GENERAL.

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REPLY BRIEF ON BEHALF OF APPELLANT.

Time will not allow as detailed a reply as could be wished to the one brief of 333 pages of which page proofs were received October 14. This, it appears, is only preliminary to another "brief."

Appellee's preliminary brief is composed of almost equal parts of abuse, inaccuracies, specious reasoning and elaborate arguments on matters not raised by this appeal.

As hardly a page of appellee's brief refrains from alleging that appellant is guilty of misstatements, plain, italicized or otherwise emphasized, it would not be possible to reply to each charge without indulging in a "brief" nearly as long as appellee's. This, the Court may be assured, will not be inflicted on it.

Occasion will only be taken to answer the charges that appellant's calculations in various particulars are "blundering," "inaccurate" and otherwise not reliable and to answer such other arguments as are apparently directed either to appellant's good faith or the fundamental soundness of his arguments.

The Stipulations Entered Into.

Appellee takes occasion in the forepart of the brief (pp. 5-7) to lay stress upon the fact that appellant stipulated the correctness of certain parts of the exhibits of Colonel Miller whose credibility as a witness appellant now attacks.

As a matter of fact, as appellee well knows, the stipulations in question were the result of the earnest endeavor on the part of the appellant to reduce the record in this Court to its least possible volume. The exhibits introduced by Colonel Miller as to cost of reproducing the plants were extremely voluminous. They were not attacked at the trial except as to overheads and appellant asked appellee to stipulate to refrain from printing these bulky exhibits. This appellee would agree to only upon appellant signing the stipulation set out in appellee's brief (pp. 4, 5). Appellant agreed to this stipulation and has not raised a question in any place of the inaccuracy of Miller's estimate of material and labor costs in reproduction. Miller is, of course, in the business of making gas apparatus and as to the cost of doing this sort of work appellant had no desire to, and, in the state of the record, could not, attack the credibility of his testimony. The admission that as to labor and material entering into such work, which witness Miller is daily engaged upon, he was accurate, by no means runs contrary to the other assumptions and claims in appellant's brief that as to things which Colonel Miller knew nothing about he was entirely an incredible witness. On such purely speculative questions as going value, hypothetical overhead, working capital, value of franchises and depreciation, nothing which we have said in our main brief is in any way abated. In these speculative matters, into which experience

enters slightly if at all and in regard to which an estimate of $40,000,000 can be as readily and plausibly sustained as an estimate of $4,000,000 Colonel Miller was thoroughly, utterly and absolutely incredible, as is best evidenced by the fact that not one of the three Masters accepted any figure of his on these speculative matters. Drastic reductions were made from his excessive figures for overhead in each case, and in regard to going value two of the Masters failed to follow him at all and the third reduced his estimate by more than one-half.

It is worthy of note in this connection that although a similar stipulation was entered into in each of the other cases yet only counsel in this case has attempted to take unfair advantage of it.

Operating Expenses.

Appellee is particularly virulent in its abuse of the appellant in connection with appellant's claim as to the reasonable operating expenses. On page 46 of appellee's brief its counsel makes great complaint because the appellant "contends that present operating costs should be only 55/100 of one cent higher than the cost found by the Special Master in 1919." As a matter of fact the costs in 1924 should be as low as in 1919. The principal item entering into the manufacture of water gas, which is eighty per cent. of appellee's production, is gas oil. In 1919, as appellee states but does not emphasize (p. 47), gas oil cost 6.7 cents per gallon and the company was using 4.08 gallons per thousand cubic feet of gas made (Rec., Newton v. Consolidated, p. 16,880). In 1923 the company was paying only 5.52 cents per gallon for gas oil and was using only 3.73 gallons per M cubic feet (Exhibit 888, p. 2,800, fol. 4,093). The saving on gas oil alone therefore in 1923 over 1919 was 6½ cents

per M made. Moreover, the evidence in the case showing the index numbers of wholesale prices issued by the Bureau of Labor and Statistics shows that in August, 1919, the index number for fuel and lighting, which includes labor and material used in the gas business, was 184, whereas in April, 1924, it was only 179 (Rec., pp. 3,053, 3,054). If appellee was paying so much more as it indicates for the other items of material and labor in 1923 than in 1919, it is difficult to understand why this was. Moreover, appellee's counsel entirely leaves out of account the great increase in volume of gas sales. These were only nineteen billion in 1919, whereas in 1923 they were twenty-four billion.

The Master in 1919 found that appellee under the 80 cent rate would have had a net return of 4.73 per M (Appellee's brief, p. 64). Under the one dollar rate this would have been 24.73 cents per M which is almost exactly the figure which appellant claims in this case.

Appellee takes great exception to the fact that appellant does not claim operating expenses as low in this Court as it did in the Court below, or in his assignment of error. Just why the appellee should complain of this more generous treatment is not clear. As appellee knows very well, the only changes were to take as basis of calculation, as to production cost, the more liberal estimate of the Master in the former case rather than the more accurate but more complicated calculation of Judge Hand, and in refraining from raising in this Court the involved question as to whether Mr. Little for the appellant, or Mr. Woods for the appellee, correctly estimated costs as of May 1st, 1924. The calculation made in the Court below and affirmed in the assignment of errors is still valid and sound. 73.65 cents claimed below and in the assignments of error in such a case as this is an ample cost of

manufacture. It is 5 cents higher than the figure found by Judge Hand, of 68.31 cents per M as the cost of making and distributing gas in 1919. We are content, however, to rest upon the figure given in our main brief of 75.73 cents per M sold (main brief, p. 38).

In view of the very evident liberality of the claims of appellant, it seems unnecessary to go in detail into the various claims of the appellee that minute errors have been made in calculations. Only three statements of appellee need to be touched upon. On page 75 appellee charges that appellant took an incorrect figure unaccounted for and thus arrived at an incorrect figure of costs per M sold. He says:

> "Even on the basis of a holder cost of 43.12 cents this figure of 45.07 is incorrect. The relationship of 'sales to make' in 1923 was 95.38 per cent. (Ex. No. 888; Rec., p. 2,800; fol. 4,091)."

It is apparent that the Consolidated Company's large force of accountants and calculating machines have been working overtime to find what is claimed to be an error of one and one-half mills in appellant's calculations. As a matter of fact, appellant stated very plainly in his brief that he correctly took the Master's figure for "Unaccounted for" of 4.31 per cent. which brings exactly the figure contended for. Perhaps some exhibit of appellee shows a different figure, but the Master's figure in this regard *is now challenged for the first time.*

The only error which has crept into appellant's calculation is the deduction of interest on taxes in the sum of $115,042.57. This would make a change in appellant's claim of less than one-half cent per cubic feet sold. If deducted from the amount avail-

able for return on page 55 of our main brief, it makes the amount available for return $5,723,759.43, which is a 6% return upon $95,396,000.

Distribution Expense.

Much is said by appellant in an attempt to distinguish the present case from that before Judge Hand. As a matter of fact the circumstances today are exactly the same as they were when Judge Hand made his decision. The bases of Judge Hand's deductions from operating expenses lie in the large amount of work done for the affiliated companies by the officers and employees of the Consolidated and which were not allocated on the books of the Consolidated Company, and for which the affiliated companies paid nothing. The present record is replete with testimony that the general officers of the appellee were also officers of many affiliated companies. Mr. Brundage, for instance, besides being secretary of the Consolidated, was also secretary of the Astoria Light, Heat & Power Company as well as assistant secretary of the Westchester Lighting Company treasurer and treasurer of the Northern Westchester Lighting Company (p. 756). Mr. Woods, appellee's chief engineer, is also chief engineer of the Standard and engineer of the Astoria Company and "consulting engineer for all of the gas companies connected with the Consolidated Gas System, in the Borough of Manhattan, Bronx and Queens" (pp. 1071, 1072). The affiliated companies all consult with Mr. Brundage in regard to their various Public Service Commission reports and Mr. Brundage helps to audit the accounts of the Westchester Lighting Company, the Northern Westchester Lighting Company, the Peekskill Light & Railroad Company, the Central Union Gas Company, the Northern Union Gas Company and the

New York & Queens Electric Light & Power Company (pp. 756, 757). The Street Department of the Consolidated Company lays all the mains and repairs all the mains of the system companies in Manhattan and the Bronx. It charges the affiliated companies for the actual labor concerned and five per cent. in addition (pp. 759, 761). When it does similar work for an outside company the Consolidated Telegraph & Electric Subway Company, it charges fifteen per cent. additional for overhead (p. 762).

Mr. Brundage did not know why there was this difference between the affiliated gas companies and the Subway Company which is also a subsidiary of the Consolidated, and he said:

> "No recent study has been made by me to see what the five per cent. and fifteen per cent. respectively covers, or to see what the charges of five per cent. and fifteen per cent. respectively are sufficient to cover everything that should be covered by these percentages" p. 762).

Although there is an apportionment of the actual work of the Engineering Department, so far as construction work is concerned for the affiliated companies, that portion of the salaries of the general officers which is properly attributable to construction work for all the companies is not allocated at all (p. 764). How much the various allocations must be a matter of guess work is indicated by Mr. Brundage's statement on page 782 as follows:

> "There was a change in the basis of the apportionment of the new business department in 1923 as contrasted with 1922. 1922 was divided on the basis of gas sales of each company. I think I was instrumental in making

that change. The change was made because it seemed to me the rental appliances on the district was a better basis of apportionment that sales of gas. It seemed more equitable to us. I cannot say that the results produced by the operation of the two methods have been such as to enable me to say that my judgment in that regard has been proven or affirmed."

The insurance carried by the various companies is self-insurance and includes property not only of the gas companies but also of the electric companies subsidiary to the Consolidated (p. 783). The Accounting Department keeps track of all the work done for other companies and bills it out to them but no share of the Accounting Department of the Consolidated is apportioned to the affiliated companies (pp. 786, 787).

That the allocations rest upon tradition and guess work more than up anything scientific is indicated by the testimony of Mr. Brundage as to the charge of five per cent. overhead on the work done for affiliated companies by the Consolidated Streets Department Mr. Brundage said:

> "I do not know who determined why five per cent. to subsidiary companies. I said that had been in force a great many years but that I do not really know who started that originally" (pp. 788, 789).

Reading in the record the testimony of witnesses Addicks (pp. 553-566); Simpson (pp. 430, 431, 435, 452, 454-456); Brundage (pp. 853-858, 1914, 1915); Woods (pp. 1071, 1155-1159), will give the Court a fair idea of the extent to which the Consolidated Gas Company does work for its affiliated gas and electric companies, the amount and value of which can only be estimated in the vaguest

way. It is apparent, as we contended in our main brief, that this situation allows opportunity for great manipulation. Judge Hand had the same situation before him and made deductions from distribution expenses only in respect to those items to which no allocations were made by the Consolidated Gas Company. We vigorously contend that Judge Hand was correct in these assumptions. While he apparently thought that his rulings were drastic, it is undoubtedly the fact that even greater deductions could be still be made before getting to the bed-rock cost of the Consolidated alone.

Both the Master and the appellee's counsel have exhausted a large amount of rhetoric in proving these services are beneficial to the Consolidated Gas Company and result in decreased costs. As we said in our main brief so we say now, that if this is the fact it is hard to see the result of the saving. When this great company with all this transfer of gas and interchange of employees, all claimed to be advantageous to it, cannot distribute gas any more cheaply than its affiliated gas companies or as cheaply as the comparatively dimunitive Kings County Lighting Company, there is something radically wrong somewhere.

Misstatements As to Appellant's Contention That the Astoria Costs Be Taken As a Standard.

It would seem to be clear from reading appellant's brief in chief that appellant has never made the claim, and does not now make the claim, that all gas should be made at Astoria. Appellant bases his contentions entirely upon the very able opinion of Judge Hand in the prior case in which Judge Hand took as a standard on which to measure the cost of making and distributing gas, the cost at

the most efficient plant of the plaintiff. Judge Hand did not say that the Manhattan plants should be immediately abandoned. Neither does the appellant say that they should be immediately abandoned. Appellant does contend, however, that the appellee in keeping plants in Manhattan has two separate and distinct purposes in view, and is conducting two separate and distinct businesses. The minor consideration in keeping these plants in Manhattan is to produce some gas in them. The major consideration is to hold the valuable land on which they stand, have the consumers pay taxes and the return upon it and when the time is ripe to sell the land and take the profit for the stockholders. As to this latter business, which is entirely separate from the gas business, it is earnestly contended that not the consumers but the stockholders should bear the additional cost of making gas on Manhattan Island, including the increased taxes, the increased cost of manufacture in less efficient plants and the return on the excessive value of the land used.

Of course if Judge Hand was wrong in 1920 the appellant is wrong today, but the appellee prosecuted no appeal from Judge Hand's rulings, and they were affirmed by this Court. The question really comes to this: Shall the Courts change the methods of calculating operating costs each time the constitutionality of the statute arises, and shall it adopt a method of calculation adapted to destroy the statute rather than one adapted to sustain it? We earnestly contend that the method used in 1919 is the method which should be used today.

On page 92 appellee, in pursuit of his erroneous assumption that appellant claims all gas should be made at Astoria, sets out a table which is so erroneous in its fundamental conception that it would

give rise to the suspicion of a lack of good faith if appellee's counsel had not constituted himself a judge in such matters and so absolved himself from such criticism.

From the entirely inflated figure of $34,732,000, which appellee claims it would cost to reproduce its Manhattan manufacturing capacity at Astoria, he then deducts the *actual investment* in the Manhattan plants at $9,761,000, leaving a balance of approximately $25,000,000 which he calls "Addition to rate base."

If the Manhattan plants of the Consolidated were claimed to be in the rate base only to the extent of the original cost this case would not be in this Court.

Rate Base.

Appellee makes a vicious attack upon the bases used by appellant in calculating the proper rate base. He attempts at great length to establish that what appellant calls "original cost of construction" is not appellee's conceded "investment." The labor is not particularly fruitful, because appellant nowhere states that he is endeavoring to find "investment," but he has tried to find the original cost of construction, and it is very difficult to avoid the conclusion that the "original cost of construction," the element stressed in Smyth v. Ames, was exactly the figure, if not considerably less than the figure given by appellant in its main brief. (p. 34.) The report of the Gilbert Committee, from which the figures are taken, is attacked as being the report of the minority member only. While this is true, yet the voluminous report of the minority member is worthy of every consideration, particularly on the question of actual cost of construction. The majority members did not report on this aspect of the case, but rested their conclu-

sions as to the validity of the merger on cost of reconstruction.

Appellee's counsel on page 122 of his brief indulges in the following moderate language:

> "In the presence of so astounding a 'method' of 'originating' a 'rate base,' it may be unseemly to cavil at mere errors of computation. For example: Appellant cites Exhibits Nos. 820 and 821 as authority for the amount of his first deduction, viz., $4,805,237, for the 14th and the 42nd Streets plants. Evidently, this figure is a whimsical and elusive as the rest, because those exhibits show the total investment in land and plant as of June 1, 1923, at those two stations, to be $3,640,809."

As a matter of fact, appellant in his modest brief is never so "whimsical" and "astounding" as appellee in the above quoted picturesque misstatement of the fact. The Exhibits referred to, together with others in the record, exactly establish that the investment as of June 1, 1923, in the 14th Street plant was $2,676,243, and in the 42nd Street plant $2,128,994. (Plaintiff's Exhibits 820, 821, 825, pp. 2300, 2328, 2343, 2348). The total is exactly $4,805,237.

Appellant concedes in his main brief and has never contested the fact that whatever inflation there was over original cost in the consolidation of 1884 must be allowed for, and it is nowhere claimed that the addition of this $9,000,000 is a recognition of increased value. In view of the decision of this Court in Willcox v. Consolidated Gas Company, *supra*, the investment that is assumed must be allowed. Merely because investment must be allowed, however, does not indicate that an investment is original cost, nor does

the report of the majority of the Gilbert Committee (printed, Newton v. Consolidated Gas Co., record, pp. 16,898-16,905) prove the amount there found to be a fair valuation of the property of the constituent companies was original cost of construction. In fact, the Committee states specifically that properties were valued on the basis of reproduction cost (record, Newton v. Consolidated Gas Co., p. 16,901).

The net result is that it is highly probable that the actual "original cost of construction" was not more than $63,000,000, as contended in our main brief (p. 63).

Appellee's Unnecessary Vigorous Defense of the Court Below.

At page 38 of appellant's main brief the following statements were made:

> "Of the three cases which have been before the Federal Courts brought by this appellee, this is distinctive in several particulars:
>
> "First.—In this case for the first time a Master heard the case who had already heard one case under this law and several under the 80-cent statute and whose attitude of mind pointed with exactitude to his final determination.
>
> "Second.—In this case for the first time the same judge who appointed the Master approved his report, taking jurisdiction over the final hearing over the protest of appellant after the case came up in its due order before another judge.
>
> "Third.—The District Court Judge affirmed the Master's report in an opinion which is cursory in the extreme compared to the ex-

> haustive and carefully prepared opinions of Judges Hough and Hand in the former Consolidated cases the Judge Campbell in the recent Brooklyn Union Gas case (see Opinion, pp. 316-321). Of the five pages occupied by the opinion of Judge Winslow one-half and more is taken up with a statement of the case. The opinion itself is, in effect, a short veto message."

Appellee does not seriously controvert the statements made, nor can he. He states what is directly contrary to the truth, however, when he says (p. 139):

> "The Attorney-General ought to know that in both Eastern and Southern Districts of New York the long established rule and practice has been that the report of a Special Master in Equity should come before the Judge who appointed the Master."

This is not the fact. The only instance when the question definitely arose and was decided was in the prior litigation of this company concluded in 1920. Motion to confirm the Master's report came up before Judge Hand who was sitting regularly in the motion part. The Gas Company moved that the Gas case be referred to Judge Mayer, who had appointed the Master. This motion was opposed by the then Attorney-General, and Judge Hand ruled that the Master was appointed by the Court, and that his report should be reviewed by the Judge before whom it came in the regular order. The same situation arising on the submission of the report in the instant case, Judge Goddard, who was sitting, took the question of referring the matter to Judge Winslow under advisement, and it was only after Judge Winslow

insisted upon its being referred that it was so referred.

It is true that in many cases the same Judge has decided the case who appointed the Master. This is the only case, however, in which, after an objection was made, the matter was so referred.

No slur upon Judge Winslow's integrity, honor, courtesy or general fairness was or is intended.

The reason for objecting to the reference of the case to him is as plain as the reason for calling the matter to the attention of this Court.

Judge Winslow showed in his opinion in the New York and Queens case that he felt very strongly that the legislation in question not only impaired the obligation of the contract, but strongly intimated that the Legislature in passing the statute had even violated the canons of "business integrity and honor." See New York & Queens Gas Company v. Prendergast, 1 Fed., 2nd, 351, 376. In conversation he expressed himself even more forcibly. Entirely aside from the confiscatory features of the case, he had decided this question of law in favor of the Company and contrary to the decisions of his own Master and of every other Master and Court which has considered the same question. Feeling so strongly upon the impropriety of the legislation and its fundamental invalidity, aside from confiscation, it is not strange to find that apparently he did not give as great attention as did Judge Hough and Judge Hand to the particular facts involved.

The facts are as they are and it is unfortunate that this large case, involving so many gas consumers in the City of New York should have been heard by a Judge whose mind was already predisposed on the issues involved and who apparently did not treat the statute with that "respect due from the judicial to the legislative authoriy" which

this Court said was essential in Knoxville v. Knoxville Water Co., 212 U. S. 1, 8.

Rates Charged by appellant since 1920.

Appellee in its brief (pp. 147 to 152) gives his attention to appellant's assertion that from March 1, 1921, to October 1, 1922, appellee was "free from all regulation." He italicizes the statement:

> "The first difficulty with this basic argument is that its fundamental assumption is utterly untrue! The fact unquestionably is that at no time during the period specified by the appellant have the rates of appellee been free from regulatory control by the defendant commission!"

How easily the lie direct rolls from the facile pen of appellee's counsel!

Unfortunately no one else seems to agree with counsel's analysis of the situation during the period mentioned. Judge Hand in his opinion in August, 1919, Consolidated Gas Co. v. Newton 267 Fed. 231, 270, said:

> "Strictly the decree should merely enjoin the defendants from enforcing the statute and leave the plaintiff to *fix such rates as it may choose*, collecting them until the state take some further action. That result I am unwilling to accept, because it relieves the company *from any regulation meanwhile*, and exposes the public to its estimate of what a fair rate should be. On the other hand, owing to the casus omissus in the law, by which the Public Service Commission has no authority to fix rates above the statutory maximum, I cannot avoid this result, unless I fix a rate myself, or provide what I shall describe in a moment."

He, therefore, fixed a rate of $1.20 per thousand in August, 1920, to last until March 1, 1921, and said (Id., p. 271):

> "I have provided that, if the States does not act before March 1, 1921, the plaintiff shall have all the fund and *shall be free to charge what it pleases.*"

The State passed no legislation from August, 1920, to March 1, 1921, and the appellee therefore fixed its own rate. Appellee's counsel does not indicate that any legislation was passed between 1920 and October, 1922, which affected its rates, nor does he indicate that its $1.50 rate or its $1.25 rate was fixed pursuant to the order of the Commission. Indeed, as lately as 1925, the Hon. Almet R. Latson, Special Master in the Brooklyn Union case, now before this Court, held that if the present statute should be declared unconstitutional, the Public Service Commission would be without authority to fix any rate above $1.00 (Record, Ottinger v. Brooklyn Union, p. 86).

The best proof, however, that the rate fixed in March, 1921, and continued until October, 1922, was the plaintiff's own idea of a compensatory rate is found in the testimony of the witness Addicks in the present record. He said in his testimony in regard to going value:

> "By Chapter 125 of the Laws of 1906, the rate of the Consolidated Gas Company was filed at, and limited to, 80 cents per thousand cubic feet of gas sold. *Prior to that time, the rates charged by the Consolidated Gas Company were limited by Governmental prescriptions and/or competitive conditions.*"
>
> "*Not until the spring of* 1921 *was the Consolidated Gas Company enabled to fix and put*

in force a rate based specifically on all of its operating costs and which included and covered fully the costs of its promotion and utilization departments in obtaining new consumers and new consumption" (pp. 1608-1609).

According to Mr. Addicks, then, the rate fixed by the company March 1, 1921, was the most satisfactory rate ever achieved by this company since 1884. When it is considered that from 1884 to 1905 the appellee and its competitors and subsidiaries had charged such exorbitant rates that it led to a major scandal and the appointment of the Hughes investigating committee it may be seen how satisfactory the rate in 1921 must have been to the officers and stockholders.

The fact of the matter is exactly as stated in the main brief, that during the period between March 1, 1921, and October 1, 1922, the plaintiff fixed its own rate and had a rate eminently satisfactory to it. The return which it received during that period is an excellent touchstone on which to judge the three elements which enter into a decision on this question, namely, rate base, operating expenses, and rate of return. That it can now under the statute earn in a year what it was content with in 1921 is eloquent proof that the $1.00 rate is not confiscatory.

Rates Charges in Other Cities.

Appellee's counsel (at pages 153-157) struggles painfully over attempting to meet the fact that in other cities rates have not been increased so largely as in New York, and that whereas New York had as low a rate or lower in 1914 than the other large cities mentioned, it now has a higher rate than any of them. He points out that Chicago in 1914 had a rate of $1.27. This is not true, but

if it were it would merely emphasize the comparatively more unfavorable situation of New York consumers in 1924. If Chicago gas companies can reduce its rate from $1.27 in 1914 to 95 cents in 1923, why should New York gas companies have to increase their rates in the same period from 80 cents to $1.15. He has much to say in regard to the load factor in various cities, but he carefully refrains from indicating that there was any change in load factor in the various cities between 1914 and 1923. He has much to say about the natural gas in the various cities mentioned in our main brief (p. 8), but he very well knows that none of the cities mentioned do use natural gas, and the figures given were for coal and water gas.

Perhaps the Court can take judicial notice of the fact that there are no natural gas in and about Washington. He says New Yorkers go away for the summer but New York is a summer resort compared with Washington.

The Sale of the Mutual Property as a Measure of Value.

The appellant maintains that the sale of the Mutual Gas Light property to the Consolidated in 1922 gives a fair measure on which to judge what the value of the appellee's property should be taken in a rate case. For the principle of accepting sales value as a value in rate cases, we cannot do better than quote appellee's own statement as to the value of such a sales value in fixing a rate base. He says in his brief (p. 115):

> "The most accurate and reliable way of determining the value of any piece of property (for example, a parcel of land) is usually to sell it under as fair competitive conditions as possible. Even then the sale price obtained on

a single offering may not always be *conclusive* as to the *value* of such property. The cost of obtaining an equal area in a closely similar location may, or may not, indicate that the single sale price was not wholly representative.

"But the value of a piece of property has often to be ascertained without actually offering it for sale. That is a common matter, in judicial proceedings and in business transactions.

"Under such circumstances, the best measure of value is to obtain experienced and reliable judgment and opinion as to what such a piece of property would sell for, if offered for sale under fair competitive conditions. The prices obtained for other and somewhat similar properties become a part of the bases for such a reasoned opinion and experienced judgment. Such an opinion and judgment as to value must be based on sound factors and should not be arbitrary or capricious.

"Testimony along the lines here being discussed was given by Mr. Woods, R. 1551-1553; Mr. Addicks, R. 1593-1594; Col. Miller, R. 1479-1480; Mr. Allison, R. 1369-1370."

The sale of the Mutual property was just such a sale.

Appellee's counsel tries to avoid the application of his theories to the sale of the Mutual properties with a very sinuous and disingenuous "explanation." He says (Appellee's Brief, p. 158):

"There was a large minority interest (45 per cent.) in the stock ownership of the Mutual Company, who were not anxious to continue in the gas business (Ex. No. 199: R., 2169-2173). They were willing to sell, and to let the majority owner have the property (R.

> 2170). The appellee could afford to pay for the property only the amount on which the Commission would allow any owner of it to earn a return. The minority could well afford to sell at that price; they could not expect to be paid more for their desired liberation. So both sides naturally asked the Commission to fix a price which would represent the sum on which the property would be allowed to earn a return (R. 2170-2171). The Commission did so (R. 2174). The Commission at that time was fixing rates for gas companies only on the basis of original investment (R. 42). It fixed the rates for all New York City gas companies on that basis, over their protest (R. 10-11; 2300-2301), on August 30, 1922 (R. 2188; Ex. No. 209), the day before the closing of the Mutual transactions (R. 2175)."

This is a likely story! The minority stockholders in the Mutual Gas Light Company were never in the gas business. The majority owner of the stock, the Consolidated Gas Company, treated the Mutual as part of its system, and all that the minority stockholders had to do was to receive their dividends. Why this should have been particularly irksome to them is not apparent. Moreover a reference to the pages above given shows that not a single statement made is borne out by the page referred to. The minority stockholders were represented by Mr. Ecker, the president of the Chamber of Commerce of the State of New York, and a very able business man. They were represented by Carter Ledyard and Milburn. That these men would advise or consent to the sale of the interests of the minority stockholders at anything less than their full market value is not believeable. The entire transaction was at arm's length, and there is

no reason to suppose that the minority interest in the Mutual Company did not get every cent that the property was worth. It is fair to suppose they got more than than the property was worth. They were the only outstanding interests in the entire gas and electric situation in the territory controlled by the Consolidated Gas Company. They had unlimited opportunity, if they so desired, to make trouble for the Consolidated as minority stockholders. They had what is known as a "nuisance value," besides their property rights as minority stockholders.

And how is it that these minority stockholders and the appellee submitted so tamely in 1922 to the informal ruling of the Public Service Commission that they would be allowed a return only on their original investment. One word from the Public Service Commission in 1922, according to appellee's counsel, was sufficient to cause the minority stockholders of the Mutual and the Consolidated Gas Company to give up a return on half the reproduction value of their property. Less than one year later the mandate of the Legislature of the State of New York fixing a rate which would be compensatory on actual investment was attacked vehemently and is now attacked in this Court.

As a matter of fact, the report of the Public Service Commission in evidence (Ex. 199, p. 2169) shows that there is absolutely no basis for the assumption that the Commission fixed or suggested the price, nor is there the slightest reason for supposing that it had any power to do so. All the Commission did was to approve the bargain made.

Again on page 159 appellee's counsel goes into italics on this subject. He says:

> "Appellant then charges (p. 16) that the appellee acquired the property of the New York Mutual Gas Light Company for $10,-

010,630, which amounts to only $3.33 per thousand cubic feet of gas made and $3.65 per thousand cubic feet sold to consumers." On this assertion, he bases a scatching arraignment of the appelee and its "rate base" of $5.57 per thousand cubic feet of gas sold to its consumers. *But the appellant's figures and his computations are wrong; why they are correctetd, his argument falls "like a house of cards"!*

"The price paid by the appellee for the gas properties of the New York Mutual Gas Light Company, which it acquired September 1, 1922 (exclusive of working capital), amounted (R. 2182-2183) to $10,010,630. This amount, divided by the 1,992,846,800 cubic feet of gas sold by the Mutual Company during 1921, the last calendar year of operation of that company (Ex. No. 765; R. 1112, folio 1649), amounted to more than $5.02 per thousand cubic feet of gas sold to consumers or $1.37 more than the price per thousand cubic feet stated in the appellant's brief."

4. Excessive Main Mileage.

The appellee does not contest the fact that the price was $10,010,630. He does not state what the gas made was. The reports of the company show that the plant New York Mutual Gas Light Company made 3,003,152 cubic feet of gas in 1922, the year the property was sold. The price paid was therefore exactly as stated, namely, $3.33 per thousand cubic feet of gas made.

Appellee's contention insofar as it refers to "gas sold to consumers" has some technical basis in fact but no practical basis. The Mutual plant, as we noted in our main brief (page 15), had a capacity far in excess of the needs of its own consumers.

It has sold the balance of its output to other affiliated companies. Technically, perhaps, the affiliated gas companies are not "consumers." But they purchased Mutual gas and the sales to Mutual consumers and to the affiliated gas companies totalled an amount which makes the sales price exactly as stated, $3.65 per thousand cubic feet sold. These figures as to Mutual make and sales during 1922 in evidence (See Monthly Book Form Report, January to August, 1922, New York Mutual Plfs. Ex. 973. P. S. C. Report 1922, Ex. 811. Reports of Mfr. 11th St. Works, September to December, 1922; Pltfs. Exs. 759, 759a, 759b, 759c).

Other facts printed in this record show quite plainly that the sales price per unit claimed by appellant was high. The make of the 11th street plant in 1923 was 3,638,340,000 cubic feet (P. S. C. Report for 1923, in evidence). There is much more justification for taking 1923 figures than 1921. The sale was not consummated until October 28, 1922. If 1923 make were taken the price would be only 2.78 cents per M made. In 1923, moreover, this plant made only 152 times its rated daily capacity, less than any other plant in the Consolidated Company. Astoria made 207 times its daily capacity.

There is some but very little merit in appellee's other contentions that the Mutual did not sell all the gas it made and that to compare it with the Consolidated it would have to add additional mains, meters and services. As to mains there would be no difference. As pointed out in our main brief (p. 15), the Mutual had half again as many miles of mains as the Consolidated per unit of sales. If meters, services and appliances were increased in proportion of make to consumer sales, or by one half, the difference would be only 18 cents per M sold. Working capital would not be more than 20 cents additional.

Nothing need be added for the fact that the Consolidated has 20 per cent coal gas capacity or, indeed, for any of the items mentioned. These would all be more than compensated for by the fact that far from being a company which would have a low valuation the Mutual in reality had many elements in it that made for a high valuation on a unit basis. Such elements are found in:

1. The excessive land valuation 49½ cents per M made as against 20 cents for the Brooklyn Union.

2. Excess manufacturing capacity. During 1923 it turned out 20% more under Consolidated direct control than under partial Mutual control in 1922.

3. Excess holder capacity.

4. Excessive main mileage.

As a matter of fact, the sale of this property is a very thorough justification of the rate base contended for by the appellant. It was made at a time when prices were higher than they are today, or at least as high. It was that sales price for which appellee's counsel so eloquently contends. It was a price fixed by hard-headed business men, each trying to make the best bargain they could. The fact that it did not contain anything specifically for intangibles, as appellee's counsel pleads (page 154), is immaterial. The purchasers of the Mutual physical property certainly left in the hands of the minority stockholders no going value, franchises or anything else which the minority stockholders could sell for a five-cent piece.

Appellee further attempts to demolish the comparison of its rate base with that found for the Brooklyn Union Company in the instant litigation, but his attempt is not particularly successful. He maintains that the Brooklyn Union Gas Company

rents much of its real estate, an alleged "fact", which does not appear anywhere in the Brooklyn Union record. Both companies rent some. The Consolidated pays annual real estate rentals of $103,000, and the Brooklyn Union pays only $70,000 (Annual Reports for 1923 to P. S. C.). He says that the unit of value of Kings County Lighting Company land is high, and this is, of course, true. The land of any small gas company is high per unit. Yet, with this enormous value of land in the Kings County Lighting case and the slavish adherence to reproduction cost which the Master showed, the Kings County Lighting Company rate base now before this Court is not as high as that of the enormous Consolidated Gas Company, nor is its land alone as high per unit of value.

Although a whole point of Appellee's Brief is given up to proving that Judge Hand's Opinion in a prior suit has no bearing on the present litigation yet in the matter of rate base per unit of consumption Appellee maintains that Judge Hand speaks *ex cathedra*. The Master assumed the same position (p. 116). Yet Judge Hand made no definite findings in regard to rate base on the basis of annual sales but what he said was only with a view to taking everything in the plaintiff's favor, in order to fix a rate pending appeal. What Judge Hand did find definitely was the cost to make and distribute gas and also the investment of the plaintiff on which he decided that it was entitled to a fair rate of return. This investment basis is the same as that adopted by the minority and majority stockholders of the Mutual Gas Light Company in 1922, with no compulsion upon them. The mere fact that reproduction costs in 1919 were in Judge Hand's opinion higher than this figure now, has no particular bearing. Whether the figure for rate base should be taken on the investment theory or the re-

placement value theory or somewhere in between is the real issue in this case.

The Inter-Connected Gas System and Improper Allocation.

On page 195 of his brief, appellee's counsel contends:

> "There is and can be no evidence that the total cost of gas (taking into account both the operating expense and carrying charges on the property employed) supplied by the New Amsterdam Company is any less than that by the Astoria Company, or that the Appellee suffers from its purchase of plant capacity and gas from the latter."

As a matter of fact it is quite apparent that the return on the investment is twice as high in the case of the Astoria Gas Company as it is in the case of the New Amsterdam Gas Company. That is indicated conclusively by the Woods Report, referred to in our main brief (p. 28), which gives the Astoria investment at $300 per M of capacity, and the New Amsterdam investment at only $159 per M of capacity. If gas from the New Amsterdam is to cost as much as gas from the Astoria including return on investment the actual manufacturing cost at the New Amsterdam plant must be much higher than at the Astoria plant, and there is a strong suggestion in Appellee's brief that this is the case, for he says:

> "The proof shows that the Astoria plant is equipped mechanically with labor-saving devices which are not justified in a smaller plant and the result is a higher investment per unit of output with a corresponding saving in the cost of operating labor."

The record of this case does not bear out appellee's contention. The cost of gas manufactured at the New Amsterdam plant as we show in our main brief, page 40, is only 1.77 cents per thousand higher than the cost at the Astoria (see main brief, p. 40, Exhibit 818, p. 2243). If the difference in taxes is taken out the net advantage of Astoria is only about 1 cent.

This slight difference in operating cost does not nearly make up for the great excess in investment for unit of plant capacity in the Astoria plant. This, as we said in our main brief, is due not to labor-saving devices, but to the fact that the Astoria plant is surrounded by a vast amount of unused land; the Astoria plant contains coal gas units which are twice as expensive as water gas units and the Astoria plant was built in recent years at high cost as compared with the cost in prior years in the case of the New Amsterdam plant.

48-Inch Mains.

Exceptions taken by appellee to the conclusions drawn with regard to the 48-inch main in the Bronx: Yet the statements made in our main brief (p. 30) are quite accurate. There is not a word of testimony, nor does appellee point to any, that the Consolidated actually needs two-thirds of the 48-inch main which runs entirely in territory in which it has not a single consumer. There is testimony that the Bronx companies only need a 30-inch main, but this is far from proving that the Consolidated needs the balance. The conclusion drawn in our main brief that the balance is assigned to the Consolidated as a convenient way of loading up the parent company until the Bronx territory needs this enormous amount, is no doubt a correct statement.

Consolidated Needs in Relation to Reserve.

Appellee's statements on page 191 of its brief that the conclusions drawn by appellant in regard to future needs of the Consolidated as compared with the other system companies is not accurate, merely bears our appellant's assertion. As appellee states:

> "From 1921 to 1925 appellee's sales increased ten per cent. as compared with 12.8 for all system companies."

It follows that the system companies other than the Consolidated had an increase of over sixteen per cent., which is more than half again as great as that of the Consolidated alone. It is true that the maximum 24-hour demand increased more than annual sales, but as stated in our brief (p. 25):

> "How much gas is made in the system is known, how much gas is consumed is known. Beyond that nothing is known or can be known."

While counsel for appellee brands this as a misstatement (Appellee's brief, p. 191), yet it is literally true and the Woods Report referred to in our main briefs show that the maximum day's demand for each company is not known and is merely calculated by applying the ratio of annual sales of each company to the maximum day's demand for the entire system (p. 1112, fol. 1684). Whether the Consolidated maximum day is as stated no one can tell.

The fact remains that the Consolidated is using a smaller and and smaller percentage of the output of the entire system, and will continue to use a smaller percentage although it is charged with a proportion of the reserve based upon its present percentage.

When it is considered that a large part of the reserve—such as the land at Astoria and Hunts Point, the excess tunnel capacity, etc.—apparently are planned for thirty or forty years in the future, the impropriety of calculating the Consolidated proportion on present ratio of sales is too apparent to demand extensive argument.

Consolidated Mains.

Appellee's criticisms of our brief (Appellee's brief, p. 216) in regard to mains does not seriously affect the point made. Whether in certain particulars Mr. Simpson did this or that in making up his appraisal is not so important. As Justice Brandeis trenchantly said in his dissenting opinion in Southwestern Bell Telephone Co. v. Public Service Commission, 62 U. S., 276, 300, Mr. Simpson

> "was making estimates requiring the projection of the engineers' imagination into the future and methods of construction and installation that have never been and never will be used by sane men."

It suffices to say that Mr. Simpson's testimony did not impress the Master as believable and the Master, instead of Simpson's figure of $39,000,000 gave only $27,000,000. This, we have shown was too high.

The question raised by appellee that there was no unnecessary "duplication" of mains (pp. 221 222), or, as appellee calls it, "paralleling" of mains, needs greater consideration than it had in our main brief.

The Consolidated Gas Company, as has been said, was formed in 1884 by the consolidation of six other companies. Each of these six had its own main system in the same territory to a large extent

and in many cases in the same street. The Mutual also occupied the same territory as did afterwards the Standard and New Amsterdam companies. The result is that the present main system of appellee is a combination of the main systems of seven distinct companies. The result is of course a great duplication of mains.

Defendants' exhibits 40 and 41 (the latter printed at pp. 2928-2956) show the extent of the "duplication" arising from this history. As appears in the explanation of the exhibits (p. 1742), mains still exist in great numbers bearing the names of Municipal Gas Light Company, Metropolitan Gas Light Company, Knickerbocker Gas Company and Harlem Gas Company, corporations which are no more.

The witness first took a square mile of Manhattan territory. No duplication was considered except as it existed on the same side of the same street.

The first tabulation (pp. 2928-2932) is as to Consolidated mains alone in this territory. It shows that in this one square mile along 26 miles of one side of a street there were no less than 83.14 miles of main or over three times as many as needed. When it is considered that main capacity increases with the square of the diameter it is plain that an equivalent in main capacity could be laid much less expensively than the present system could be relaid. For instance, there is one instance where four 6 inch mains and one 8-inch main are found on the same side of a street for 3958 feet (p. 2933). These mains Simpson expected to put down again, each one separately. Assuming such a main capacity, elementary mathematics shows that the entire capacity of these 5 mains with a total diameter of 32 inches could be replaced by one 16-inch main. One 16-inch main could certainly be laid for a cost

less than the cost of two 6 inch mains and for much less than the cost of 4 six inch mains plus the cost of one 8 inch main.

What the amount of duplication was which existed throughout Consolidated territory does not appear, but sufficient appears to indicate that that the padding of the reproduction estimate on this account alone was very great.

Exhibit 42 (pp. 2939-2943), moreover, shows that beside duplications in Consolidated mains as such these are large duplications of Consolidated mains by mains of the other affiliated companies. If the main systetm were to be reconstructed this also would greatly reduce the cost. If a new system were constructed but one main on each side of the street would suffice for all companies and the cost could be apportioned.

Witnesses Eddy and Olmsted who put in the exhibits described above were cross-examined at some length (pp. 1864-1876), and while it appeared that in certain particulars their exhibits did not accurately indicate the duplications yet the fact that the duplications were great remains unchallenged.

In Pacific Gas & Electric Co. v. San Francisco, 265 U. S., 403, the record in this Court reveals that in a similar situation in San Francisco the City engineers threw out of the inventory all but one main on each side of each street and were upheld by the District Court in so doing. A similar treatment of appellee's mains would no doubt halve the work and cost of reconstruction.

Depreciation.

The question is squarely raised by appellee as to whether or not this Court has come to consider sound the so-called "service efficiency" theory with all its implications. In our main brief we call this theory "heresy" because it was so declared in

Minnesota Rate Cases, 230 U. S., 352, 456.

The question then arising is whether by its decisions in

> Pacific Gas & Electric Co. v. San Francisco, 265 U. S., 408;
> Board of Public Utilities Commission of N. J. v. N. Y. Telephone Co., U. S.,
> City of Fort Smith v. Southwestern Bell Telephone Co., U. S., affg. 294 Fed., 102;

this Court has reversed its former doctrine and come to the more recent theory.

There seems to be no reason to suppose that this is the case.

Board of Public Utility Commrs. v. New York Telephone Company, 70 Lawyers Ed., 436, is no authority for the "service efficiency theory." This case dealt mainly with a depreciation fund that had been accumulated to cover all the depreciation that existed in the plant. The recognition of the necessity of a depreciation fund and the passing upon its ownership is not a denial that depreciation exists. It is rather a recognition that it does exist.

City of Fort Smith v. Southwestern Bell Telephone Co., 70 Lawyers Ed., 236, is no authority for the "service efficiency" theory. That case was an appeal from Southwestern Bell Telephone Co. v. Fort Smith, 294 Fed., 104, in which the District Court passed on a suit to enjoin putting in effect ordinance rates for service. Concerning depreciation the District Court stated on page 105:

> "There is also no dispute with reference to depreciation, except that the city engineers contend that the engineers for the company did not take into consideration 'hidden depreciation' and did not make sufficient allowance for

age. The contention on behalf of the company is that the greatest factors to be considered in determining depreciation are inquacy and obsolescence."

It may thus be seen that even the company's engineers has made an allowance for age though distinguishing it from "hidden depreciation" but the city did not think the allowance for age was large enough. As allowance for age is accrued depreciation and as inadequacy and obsolescence are two of the great causes of accrued depreciation, as admitted by the company, the question in the case involving depreciation was the amount of the accrued depreciation. Counsel for appellee again seeks to confuse. His statement as to allowance for age is negatived by the quotation made from the opinion of the lower court. By alleging that actual inspection is a better method of proof than a straight line or some other method of determining depreciation, he seeks to deny the existence of all depreciation. This is a non-sequitur.

In the Pacific Gas and Electric case this Court, so far as its opinion indicates passed only on the method of arriving at depreciation not on whether or not it exists.

When we examine the records in this case and in the Fort Smith case we find that while the service efficiency theory was championed by the witnesses yet they did recognize depreciation as a fact and made substantial deductions for it.

In City of Fort Smith v. Southwestern Bell Telephone Company the chief witness for the utility, Mr. Mahood, put in a table entitled not "Cost to Make New" as in this case but

"Reproduction Cost New Less Deterioration."

In this table of every item of physical property was depreciated from 5 to 28%."

Compare this with the results of the "Cost to Make New" theory in this case. As appellee's brief indicates in his table (Appellee's Brief, p. 301) his "experts" found only two items on which anything could be spent "to make new." Buildings valued at $15,000,000 some of them 50 years old it was sworn could be made new with an expenditure of $181,562 or 1.2%. Plant valued at $37,500,000 it was sworn could be made new for $1,057,525 or approximately 2.75%. On the entire balance of the inventory appraised, exclusive of land at about $50,000,000, *not one cent,* it was testified need be spent to put it in conditioin equal to new. The total amount of expenditures testified as necessary amounted, as we said in our main brief to *less than* 1% of the Master's valuation, exclusive of land.

In the Pacific Gas & Electric case the deductions were similarly substantial compared with the testimony in this case as to cost to make new.

From a total appraisement of $13,000,000 the witness Jones, whom this Court followed, deducted $828,915.41 or 6.3%. He called the amounts deducted "Accrued Deterioration, Expected Abandonments and Replacements as of June 30, 1914." From a valuation one-tenth of that in this case he deducted more than two-thirds the amount testified to in this case and deducted by the Master against the protest of appellee.

As an indication of the absolute and total difference in the theories underlying the deductions for depreciation in the Fort Smith and Pacific Gas Company cases we print here a table comparing the deductions made in those cases with those make the cases now before this Court with those in the Fort Smith case.

Comparison of depreciation deductions an d infinitesimal amounts allowed for costs "to put in condition as good as new."

	Plants	Buildings	Mains	Services	Meters	Equipment	Appliances	Per Cent Deductions on Tangible Property	Per Cent Deductions on Total Reproduction Cost
CONSOLIDATED—									
Master's Reproduction Cost	$32,046,491	$13,518,029	$27,450,000	$ 4,350,000	$ 6,500,000	$ 1,155,000	$5,750,000		
Burt and Miller costs to put in condition as good as new	1,656,276	184,152	none	none	none	none	none		
Depreciation %	3.3%	1.4%		Tunnels 6,500,000 none				1.3%	.6%
BROOKLYN UNION—									
Master's Reproduction Cost	$14,500,000	$ 7,000,000	18,000,000	6,250,000	4,000,000	600,000			
Burt and Miller costs to put in condition as good as new	528,000	20,756	none	none	none	none			
	3.6%	.3%						1.2%	.9%
KINGS COUNTY—									
Master's Reproduction Cost	$ 1,500,000	$ 750,000	2,898,000	1,109,000	816,000				
Burt and Miller costs to put in condition as good as new	416,500	1,800	none	none	none				
	.1%	.2%						.6%	.4%
PACIFIC GAS CO.—	Not separated as to Plants, Buildings, etc.								
Accrued deterioration, expected abandonments and replacements	Total appraisment $13,000,000 Deductions for accrued deteriorations $828,915—6.3%							——	6.3%
FORT SMITH CO.—									
Deterioration	14%	9%	11%	——	——	22%		No figures available	

For the first time in this whole litigation appellee in its present brief attempts to nominate the amounts for "Cost to Make New," "Actual Depreciation" (Appellee's Brief, p. 292), saying that

> "the nature, extent and amount of actual depreciation was undisputed."

It was simply unproved. Not only that but the existence of any depreciation, actual, theoretical, accrued observed or otherwise was vigorously denied. And counsel urged, as he very faintly urges here (Appellee's Brief, p. 296) that even the negligible amounts testified to be not deducted. As he said in his brief in 1923 so he says today, that

> "the most important consideration *is that no countenance or support be given, by any manner or means to the making of any deduction for any manner of so-called 'depreciation.'*"
> (Our main brief p. 61.)

He said then that this Court was not yet "sound" on this proposition.

He says now that this Court by its decision in the Pacific Gas and Electric case has become "sound" on it.

His contention comes to just this for he admits that in the Fort Smith case both sides agreed that there was depreciation and the only question was that account (pp. 290, 291, 292). He also apparently concedes that the New Jersey Telephone case did not specifically decide this question though he entirely misstates what it did decide.

Annual Depreciation Reserve.

The final contention of appellee in regard to depreciation, and it is the plea of counsel in the other cases as well, is that the appellant does not suggest

any annual depreciation deduction as a part of operating expenses. As a matter of fact, as appellant's counsel well knows, the authorities of the State of New York, particularly the Public Service Commission long attempted to constrain the appellee to set up such a reserve. The uniform system of accounts which was put in evidence in this case —and is printed in full in Ottinger v. Brooklkyn Union (pp. 1714 to 1933)—provided in 1909—in regard to such a depreciation fund and annual charges thereto as follows:

"ACCRUED AMORTIZATION OF CAPITAL.

"Credit to this account such amounts as are charged from time to time to 'Operating Expenses,' or other accounts to cover depreciation of plant and equipment, and other amortization of capital. When any capital is retired from service, the original money cost thereof (estimated if not known, and where estimated, that fact and the facts upon which the estimate is based shall be stated in the entry), less salvage, shall (except as provided in the account (No. G100) 'Fixed Capital, December 31, 1908'), be charged to this account. The amount originally entered or contained in the charges to any capital account in respect of such capital so going out of service shall be credited to such capital account, and any necessary adjusting entry made to the appropriate sub-account under the account 'Corporate Surplus or Deficit.' (p. 1751, B. U. Record.)

(G842) General Amortization—Gas.

"Charge to this account month by month the amount estimated to be necessary to cover such wear and tear and obsolescence and inade-

quacy as have accrued during the month in the tangible gas capital of the corporation; and such portion of the life of intangible fixed capital as has expired or been consumed during the month; and the amount estimated to be necessary to provide a reserve to cover the cost of property destroyed by extraordinary casualties; less the amounts charged for that month to the various repair accounts in Gas Operating Expenses. The amount charged (or credited) to this account shall be concurrently credited (or charged) to the reserve account No. 374), 'Accrued Amortization of Capital'.

NOTE A.—Until otherwise ordered, the 'Amount estimated to be necessary to cover such wear and tear and obsolescence and inadequacy as have accrued during' any month shall be based on a rule determined by the accounting corporation. Such rule may be derived from a consideration of the said corporation's history and experience during the preceding five years, and the accrual may be on the basis of amount of gas sold. Amortization of intangible capital shall likewise be based on rule. Whatever may be its basis, such rules and a sworn statement of the facts and expert opinions and estimates upon which they are based shall be filed with the Public Service Commission on or before January 1, 1909; each amendment of any such rule and a sworn statement of the facts and expert opinions and estimates upon which such amendment is based shall be filed with the Public Service Commission before it is used by the accounting corporation, and shall show the date when it is to be effective. Such rules and statements shall be filed upon sheets 8½ x 11 inches or 9½ x 12 inches and shall be entitled 'Rule of

the (here naming the accounting corporation) concerning Amortization.'

"NOTE B.—When any capital is retired from service, the amount (estimated if not known) originally charged to a capital account, and (except as provided in the account (No. G100), 'Fixed Capital, December 31, 1908'), the original money cost of such capital, less salvage, if any, shall be charged to the reserve account, 'Accrued Amortization of capital,' any necessary adjusting entry being made in the proper account under 'Corporate Surplus or Deficit.' Where capital substantially continuous and can be satisfactorily individualized, it shall be kept in efficient operating condition through repair, and the renewals and replacements of parts thereof shall be considered repairs. In the case of buildings, towers, bridges, trestles, and other separate structures capable of being readily individualized, charges to this account must be sufficient to provide (in respect of such capital and except as provided in the account (No. G100), 'Fixed Capital, December 31, 1908,') in the account 'Accrued Amortization of Capital' by the time such structures go out of service a reserve equal to the original money cost thereof, less salvage, to which account such original cost, less salvage, shall be charged" (pp. 1781, 1782; B. U. record).

It was under these sections that the fund which now amounts to over twelve millions of dollars began to be accumulated. As witness Brundage testified (p. 816) the company originally kept an account labeled "Amortization of Capital." Later the company decided that in spite of the Commission's order it would not amortize its capital although it

continued to set aside out of operating expenses large amounts for "Deterioration, wear and tear, etc." The Public Service Commission continually protested against the failure of the appellee and of the other gas companies which followed its leadership to set up any annual depreciation reserve under these sections. It is interesting—in view of the present insistence of appellee that proved "Actual depreciation," to read some of the very disrespectful and contumacious communications which, apparently under the same hand which wrote its present brief, this company addressed to the Commission delegated by the Legislature to prescribe methods of accounting for gas companies. In its 1920 report to the Public Service Commission —which is in evidence as Defendant's Exhibit 70, but not printed—the appellee wrote to the Commission in response to the Commission's demand that it make an entry under "Accrued Amortization of Capital," as follows:

> LINE 34 ACCRUED AMORTIZATION OF CAPITAL.
>
> "No entry would be appropriate to this line, and none could be accurately made. The Commission form asks the application of a theoretical formula which is contrary to law and contrary to the known facts of our business. That the Commission had no power or right to require this company or any other company to do any such thing as is sought, has been definitely and decisively established by the Court of Appeals, the statute from which the Commission derives its power (Peo. ex rel. N. Y. Rys. Co. v. P. S. C., 233 N. Y., 273). That such a formula as is sought here to impose upon this company has no foundation in engineering experience, accounting practice, business management, or legal concepts, has

been definitely decided by a Court whose decision ought to be regarded by the Commission as controlling, since the plaintiff in that suit was this company and one of the defendants, strongly urging the contention rejected by the Court, was the Commission itself (Cons. v. Newton and other cases)."

The Commission again wrote them in 1921 and at page 36 of the same report appears a similar disrespectful rejoiner as follows:

> "This company has no 'Rule concerning Amortization,' and has not amortized its capital. We are selling gas to our consumers, not our property piecemeal. Our consumers pay only the cost of gas service, including return on investment; we have never asked them to pay for any such *absurd thing as 'Amortization of Capital' on any theoretical basis.* The loss between 'book value' and 'Salvage value' realized on Fixed Capital withdrawn from service during the year 1921 is properly charged to the Reserve for Renewals and Replacements. Plant withdrawn from service as shown on this page."

After this exchange and in the year 1923 the uniform system of accounts was amended to change the name of the reserve "Accrued amortization of capital" to "Retirement reserve" and the expense account "General amortization" to "Retirement expense." These two accounts as now existing read as follows:

> "RETIREMENT RESERVE.
>
> "To this account shall be credited such amounts as are charged to the operating ex-

penses account 'Retirement Expense,' appropriated from surplus, or both, to cover the retirement loss represented by the excess of the original cost, plus cost of dismantling, over the salvage value of fixed capital retired from service. When any fixed capital is retired from service, the original cost thereof (estimated if not known, and where estimated, the facts on which the estimate is based should be stated in the entry) should be credited to the proper fixed capital account and charged, plus the cost of retirement, less salvage, to this account. If the credit balance in this account is insufficient to cover the retirement loss, the excess over the balance contained in the reserve should be charged to account No. 132, 'Property Abandoned,' which see, or to other appropriate account.

"The losses which this account is intended to cover are those *incident to important retirements of buildings, of large sections of continuous structures, like gas mains or of definitely identifiable units of plant or equipment,* and the object of the account is that the burden of such losses may as nearly as is practicable be equalized from year to year. No portion of the amount reserved for retirement shall be diverted to Surplus, or other use made thereof, except as above provided, without the approval of the Commission.

"NOTE A.—When property is retired whose ledger value has been reduced below original cost, only the remaining ledger value shall be written off as retirement loss.

"NOTE B.—When any property is retired whose ledger value is greater than the known or estimated cost, such excess shall be charged to Profit and Loss.

"NOTE C.—If any property is sold for more than its original cost, the excess of its selling price over the cost of the property plus the cost of dismantling and selling, shall be credited to this account.

"NOTE D.—If the accounting company has, previous to the effective date of this uniform classification of accounts, maintained a reserve under some other title, such as 'Depreciation Reserve' or 'Accrued Amortization of Capital' for the purpose of equalizing retirement losses, the balance in such reserve, as at the effective date of this classification, shall be transferred to this account. (p. 1846, B. U. record.)

D. C. B. A. 782. Retirement Expense.

"This account shall include such amounts as the accounting company charges to operating expenses, in addition to amounts appropriated from surplus, to provide a reserve against which may be charged the original cost of all property retired from service, plus the cost of dismantling, less salvage. The amounts charged to this account and those appropriated from surplus and credited to the 'Retirement Reserve' shall be in addition to the necessary cost of keeping the plant and equipment in a high state of efficiency through charges to the regular maintenance accounts.

NOTE.—*It is the intent of the classification that a reserve shall be provided, either through retirement expenses or by appropriations from surplus, or both, sufficient to cover all retirement losses that may reasonably be expected*" (p. 1929, B. U. record).

It should be particularly noted that the retirement expense provided for in the order of the Pub-

lic Service Commission is meant to be a real depreciation reserve.

It will undoubtedly be conceded that nothing is more subversive of proper accounting than to fail to set up an adequate reserve to take care of the retirement of property due to depreciation, inadequacy and obsolescence. Many of the scandals that arose fifty years or more ago in public utility financing can be traced to the utter failure of public utilities to set up adequate reserves out of expenses. One of the principal functions of public regulation of accounting system is to make sure that property is kept intact and that sufficient reserves are set up and sufficient charges are made to operating expenses to insure the retirement of property without the depletion of capital. As a representative of the Attorney-General of the State of New York I would be the last to suggest that adequate reserve for this purpose should not be set up. The question is whether such reserves have been set up. The sections above quoted indicate that for the past seventeen years the Public Service Commission has required in one form of words or another that such reserve be set up. The books of account of this company show that it has actually accumulated, ostensibly for this purpose, over twelve million dollars and is charging to operating expense 3.5 cents per thousand cubic feet sold for this purpose. If this sum is not enough to take care of retirement due to depreciation, inadequacy and obsolescence why did not the appellee show at the trial that a larger amount should be deducted, The burden was on it to prove its just operating expenses and not upon the officials of the State of New York.

The only reason that can be assigned for the failure, if failure there was, to prove the necessity of adequate annual appropriations for retirment

due to depreciation, inadequacy and obsolescence is the answer indicated in the above quoted letters to the Public Service Commission—namely: That this company denies the existence of depreciation, inadequacy or obsolence and has no intention of providing out of present rate for the retirement of property presently used. That this is the case, is indicated by the fact the 42nd Street plant which, after sixty years of service, was finally wiped off the books in October, 1923, has not yet entirely disappeared from the capital. Witness Brundage testified that a portion of the cost of this plant remained as an asset of the company in the account called "Unamortized portion of 42nd Street plant" (p. 791). It is apparently the intention of this company to make future consumers pay for the retirement of this old plant while they also pay a return upon the new plant which has just been erected. It is difficult to see the distinction between what has been done by this company in this case and what used to be done fifty years ago by the public utilities which refrained from setting up adequate reserves for retirement of the property and which carried in their assets property which actually no longer existed.

Appellee objects to this method of accounting being called "Heresy." To my mind it is the rankest "Heresy" and the most subversive and dangerous treatment of the accounts of a great public utility. It is, however, the natural and inevitable result of the service efficiency theory. Taken in its essence this theory holds that if property is continually kept up through current maintenance charges there need be no reserve for retirement and no charges to operating expenses to cover such reserve. If this Court in the Pacific Gas & Electric case has actually approved this subversive theory, this denial of depreciation—this return to obsolete

accounting methods of seventy-five years ago, we would be very much surprised.

Upon this score we also call this Court's attention to the provision of the Interstate Commerce Commission prescribing a uniform system of accounts for telephone companies:

> "The rate of depreciation should be fixed so as to distribute, as nearly as may be, evenly throughout the life of the depreciating property the burden of repairs and the cost of capital consumed in operations during a given month or year, and should be based upon the average life of the units comprised in the respective classes of property."

That appellee really plans to shift the burden of its future retirements to consumers who never had the benefit of the property to be retired is amply demonstrated in its brief. It plausibly argues (Appellee's brief, pp. 313, 314):

> "As already indicated on pages ———, *ante* the record in the present case, or in the case of any other gas manufacturing and distributing concern, pictures a linked system of plants, pipes, tunnels, commercial buildings, and equipment, all composed of hundreds of millions of parts.
>
> "They will not all fail at once. Neither the property as a whole, nor any considerable part of it, is likely ever to have to be rebuilt in any one year. Parts are replaced daily and charged to repairs. Where is the line between a repair and a replacement? The replacement of a bolt is the repair to a link of a conveyor; the replacement of a link is a repair to the conveyor; the replacement of a conveyor is a repair to the plant; the replacement of a plant is a repair to the system.

"In such a system, the cost of replacements averages a nearly equal annual amount, and more nearly equal amount over a period of five years. All things are relative and what may be termed a replacement in a small shop may be termed a repair in a great combination of plants. No one would think of accumulating a depreciation reserve for the cost of yearly repairs, or would write off depreciation of small articles commonly replaceable in a year or less. The annual charges for repairs and replacements are enough to cover the costs of ordinary annual replacements. Why accumulate a reserve in advance when it is not necessary for the purpose? Why not deal with ordinary replacements as repairs are commonly dealt with, viz., as a self-equalizing charge to the operating expenses of the year?

"As to major replacements, the superseding of large units of plant, equipment or distribuing system, they are made for the purpose of serving a greater number of consumers or of serving existing consumers more efficiently and economically.

"They thus result in economies and are intended to secure economies, and should be amortized over future years. *Present* consumers should not be asked to create a reserve to provide for something which will benefit them not at all and will save money only for future consumers."

If, as will be to appellee's interest the Manhattan plants and excess holder stations are retired in the near future when the Hunts Point and Astoria properties are fully developed the course of procedure will this:

The stockholders will take the profit on the land.

The present reserve originally set up for "wear and tear, inadequacy, obsolescence, contingencies, etc., will be, if it has not already been, distributed as dividends. There being no reserve to which to charge the millions of dollars of plant these millions will remain as assets "unamortized," and the future consumers will not only have to pay a rate to give a return on plant actually used but an additional amount to "amortize" what is already as dead as Noah.

It is this method of accounting which appellee seeks to have this Court approve. Such approval should not be given.

Working Capital.

In view of the many compliments paid to the Public Service Commission by various counsel for appellees and in view. As Appellee in this case says (p. 3):

"The Commission participated actively in the conduct of the trial before the Special Master, in seeing to it that any available facts in support of the statute were fully and fairly brought out."

In view of the so evident belief on the part of appellee in the Commission's fairness we print from the Commission's brief in the Court below that portion bearing on Working Capital.

In its brief counsel for the Commission said:

> "The amount allowed by the Master for working capital for the plaintiff is improper and excessive.
>
> "The amount allowed by the Master for working capital for the Astoria Light, Heat and Power Company is wholly unwarranted and should be disallowed.
>
> "In an attack on a rate fixed by the Legislature, the amount allowed for working capital

should be a reasonable amount. In the present case we submit that the amount allowed by the Master for working capital for the plaintiff is improper and excessive, and that the amount allowed by the Master for working capital for the Astoria Light, Heat and Power Company is wholly unwarranted and should be disallowed by the Court. The amount allowed by the Master for working capital for the plaintiff is $3,500,000, and the amount allowed for the Astoria Company is $2,400,000, making $5,900,000 in all. We think that the $2,400,000 for working capital for the Astoria Company should be wholly rejected, and that the item of $3,500,000 for working capital for the plaintiff herein should be greatly reduced.

"Working capital is in effect a sort of financial bridge by which the utility is able to span the time between the rendition of service and payment for it." (*Re Idaho Power Co.,* P. U. R. 1923 B, 52, 81). It "consists of the money needed for materials and supplies plus the cash required for operating expenses, pending the collection of accounts from users of service" (*Stone* v. *New York Telephone Co.,* P. U. R. 1921 D, 736, 747). So long as these requirements are met the utility has no cause for complaint. The utility is of course entitled to a reasonable amount for working capital, buf the consumer should not be burdened with having to pay a return on excessive amounts based on vastly inflated estimates far in excess of the needs of the utility as demonstrated by its experience.

"The Consolidated Gas Company is well entrenched and established, and has good credit. There is evidence that it finances its subsidiaries. No evidence is found in the present

voluminous record that the company has lost credit. Having good credit, the company does not pay cash for coal, coke or oil. Bills are payable on the 15th of the month following the receipt of materials. There is a weekly and a monthly payroll. There are receipts of cash every working day. Thus the gap to be bridged is a short gap at best. With the credit this company has it could do without working capital. Here the income could precede the outlay. Commissioners skilled in such matters have given weight to these considerations in making allowances for working capital. Thus, in *Foster* v. *Kellogg Power & Water Co.*, P. U. R. 1923-B, 105, the Idaho Commission allowed one-twelfth of the annual operating expenses as working capital. See also—

Re Mountain States Telephone & Telegraph Co., P. U. R. 1921 B 739.
Breen v. *Northern New York Utilities, Inc.*, P. U. R. 1921 B 463.
Re Southern California Edison Co., P. U. R. 1921 D 65.
Re Commercial Telephone Co. of Warsaw, P. U. R. 1921 C 647.
Re Wisconsin Telephone Co., P. U. R. 1921-E 171.

"Even if the company paid cash for everything and bought nothing on credit, it would seem that an allowance of an amount sufficient to cover one month's expense should be sufficient.

"From plaintiff's exhibit No. 814 it appears that the total cost of gas in the holder (eliminating certain items that have no place in the working capital of the Consolidated Gas Company) is $1,877,129.60 for gas made by the

Consolidated Gas Company, and $7,110,506.38 for gas purchased from the other companies, or a total of $11,987,506.98 for the year. One-sixth of this amount is the average for two months, the usual allowance by Commissions. That figure is $1,997,939.33. That this amount is not too low is clear when we consider, as above pointed out, that the coal is bought on credit, the coke is bought on credit, and the oil is bought on credit. The payroll even is a credit proposition; the smaller salaries are paid each week, the larger ones at the end of the month; receipts come in daily.

"From the report of the Consolidated Gas Company to the Public Service Commission for the year 1923, we find the total costs, materials and supplies, of all the mains laid in 1923 was $60,065.05, one-sixth of which was $10,010.84, the average cost for two months. The same report while not satisfactorily clear to the lay mind shows the total outlay for services as $91,175, one-sixth of which is $15,196, the average cost for two months.

"The testimony in this case is that the peak outlay for mains and services is in the warm weather and the peak cost for gas making materials is in the winter months.

"Adding the above averages for mains and services to the above average for two months of cost of producing gas, we have $2,023,146.17.

"The average cost for the installation of meters per month during 1923 was $20,131.57, and the average for two months would be $40,263.14. Let this be added to the above figure of $2,023,146.17 and the total will be $2,063,409.31.

"In view of all the circumstances surround-

ing and factors entering into this case, we think that $2,500,000 would be a fair maximum allowance for working capital. The consumers of the Consolidated Gas Company should not be penalized by the carrying charges of other companies or to provide for them in any way working capital."

Appellant has maintained and still maintains that no more than $4,000,000 should have been allowed for this item.

Evidently appellant's contention is most liberal to appellee.

Respectfully submitted,

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